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May 3, 2007

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Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Arizona Corporation Commission

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**RE: Response to Yuma Cogeneration Associates' Statements Concerning the Request for Approval of Special Procurement Agreement between Southwest Gas Corporation and Yuma Cogeneration Associates.**

Docket Number: G-01551A-07-0186

Dear Commissioners:

As you are aware, Southwest Gas Corporation ("Southwest") and Yuma Cogeneration Associates ("YCA"), a subsidiary of CE Generation which is owned by TransAlta Corporation and Berkshire Hathaway, Inc., recently completed the execution of a new Special Procurement Agreement ("SPA"). CE Generation, LLC., 2006 Consolidated Financial Statements 8 (2007). Southwest filed the SPA for Commission approval on March 28, 2007. It was assigned Docket Number G-01551A-07-0186. Staff filed its Memorandum and Recommended Opinion and Order on this matter on April 20, 2007, recommending Commission approval with a modification limiting the primary term to one year with neither renewal nor termination clauses. On April 23, 2007, YCA sent a written request to the Commission for relief from the termination clause contained in the SPA. YCA claims it executed the current SPA under duress and that the agreement violates Southwest's Tariff and its Master Agreement. Southwest appreciates the opportunity to clarify the underlying circumstances regarding the SPA's negotiation and execution.

**Background**

Southwest and YCA operated for over a year on a month-to-month basis, pursuant to a July 1, 2004 Special Procurement Agreement ("2004 SPA"), after the primary term had expired. The 2004 SPA was approved in Docket Number G-01551A-04-0309



(D.67064) and modified by the Commission on July 28, 2006, to incorporate changes for penalties and overrun charges levied by El Paso Natural Gas ("El Paso") and attributable to YCA, (D.68851). As a result of the modifications approved by the Commission, the 2004 SPA required a thirty-day termination notice by either party.

On numerous occasions over the last two years, Southwest and YCA met and discussed various options for service. Throughout these discussions, Southwest emphasized the uncertainty that surrounded Southwest's El Paso transportation service and the difficulties associated with maintaining the 2004 SPA. Southwest understands YCA's obligations and commitments to sell and provide energy to San Diego Gas & Electric Company through long-term power sales agreements. CE Generation at 22. In consideration of continuing service and tariff uncertainties related to the pending El Paso Rate Case and other business considerations, Southwest executed its right to terminate the 2004 SPA, on January 30, 2007. However, Southwest agreed to extend service under the 2004 SPA for YCA's benefit on the condition YCA continue to negotiate in good faith.

#### **YCA's Options for Service**

YCA alleges that Southwest only allowed YCA a short period of time to investigate alternatives. In truth, YCA knew from numerous meetings over the past two years that the 2004 SPA could not continue indefinitely and that Southwest desired to find other alternatives for service. Even if YCA was not aware of Southwest's intentions, YCA knew that the Commission had already approved a thirty-day termination provision in July 2006. Southwest never prevented or precluded YCA from evaluating its business decisions in a prudent manner prior to Southwest's notice of termination. Furthermore, Southwest is not responsible for YCA's failure to prepare for the possibility that Southwest would terminate the 2004 SPA by providing the required thirty-day notice. Nevertheless, Southwest has since made every effort to accommodate YCA.

Southwest initiated several meetings and discussions to evaluate YCA's service alternatives. YCA has several options for gas service to its facilities including sales service on Schedule G-60, transportation service pursuant to its negotiated Transportation Agreement, negotiated sales service pursuant to the tariff provision of Schedule G-30 and negotiated sales service pursuant to the SPA provision of Schedule G-30. The G-30 negotiated sales and negotiated SPA services are provided on terms mutually agreeable to the customer and Southwest. YCA chose to negotiate with Southwest for a new SPA and decided not to pursue its other alternatives.

Southwest has never denied YCA the contractual right to receive service under its existing Transportation Agreement and never demanded that YCA take service under the G-60 Tariff. The G-60 tariff is the traditional sales service tariff available to serve a customer like YCA if it is not served by a SPA under the G-30 tariff. YCA had alternatives and chose to pursue the SPA presumably because it was the best fit for its business model and value added services were obtained that were not available under the other two options.



### **Capacity on the El Paso Natural Gas Yuma Lateral**

Southwest and Arizona Public Service Company ("APS") hold capacity rights on the Yuma lateral. Southwest acknowledges the constrained conditions and the impact on natural gas delivery to the Yuma area. YCA has the ability, as does any other entity, to expand such capacity as long as it is willing to provide El Paso the necessary capital or a Transportation Service Agreement (TSA) to fund such an expansion. YCA is not precluded from exploring capacity expansion.

### **YCA's Duress Arguments Lack the Required Elements**

For duress to exist under Arizona law, the threat must have "placed the party entering into the transaction in such fear as to preclude the exercise by him of free will and judgment." *Dunbar v. Dunbar*, 429 P.2d 949, 953 (Ariz. 1967). Southwest openly and fairly negotiated with YCA. YCA, on its own accord, held discussions with its management and Board of Directors to evaluate its alternatives. YCA decided it was in its best interest to pursue the SPA and exercised its free will and judgment in doing so. YCA understood and considered in its decision-making that the SPA would contain the one-year notice for termination.

The courts in Arizona further addressed when duress will invalidate a contract in the context of business negotiations. In *Frank Culver Electric, Inc. v. Jorgenson*, 664 P.2d 226, 228 (Ariz. Ct. App. 1983), the court held, "A charge for economic duress...must be based on the acts or conduct of the opposite party and not merely on the necessities of the purported victim, ...and the mere fact that a person enters into a contract with reluctance, or as a result of the pressure of business circumstances...or economic necessity, does not, of itself constitute...economic duress."

YCA is an experienced operator and understands the nuances of dealing in the negotiations of purchase power agreements. In 2006, CE Generation generated approximately \$268 million in operating revenues from YCA and its two other natural gas-fired cogeneration facilities. CE Generation's total fuel expense in 2006 for natural gas was \$103.4 million and included a decrease in fuel expenses of \$4.8 million. CE Generation at 23. YCA's claim that a change in service would adversely affect its monthly fuel expenses is insufficient to satisfy the *Culver Electric* standard for determining duress. In other words, Southwest's actions failed to rise to the level of "wrongful, unlawful or unconscionable," while negotiating with YCA. *Culver Electric*, 664 P.2d at 228. Simply put, YCA freely executed and negotiated the SPA.

### **SPA does not Violate Tariff or Master Agreement**

The G-30 tariff is permissive and does not preclude the parties from agreeing to a notice period greater than six months. In addition, the Commission has authority to approve the one-year notice period. The Master Agreement defines which other agreements are subject to the terms and conditions of the Master Agreement. Although



the initial SPA was subject to the Master Agreement, the Master Agreement was never amended to include subsequent SPAs. Even if the Master Agreement was applicable to the proposed SPA, the parties can contractually modify the terms and seek approval from the Commission.

### **Staff's Recommendation**

Southwest is prepared to render service as modified by the recommendation of the Staff to limit the primary term to one year with no renewal or termination clause. Southwest further accepts Staff's requirement to provide further demonstration of YCA's "real and viable" bypass option, in the event that Southwest and YCA propose a new SPA once the instant agreement expires. Meanwhile, approval of the SPA will continue to provide benefit to the other gas sales customers through credits to the gas cost balancing account. For the 12-months ended March 2007, the YCA 2004 SPA produced \$326,571 in such credits. Southwest expects a similar amount to accrue to the gas cost balancing account over the 12-months of the proposed SPA.

Staff's recommendation, if approved, renders YCA's requested relief irrelevant and unnecessary. Regardless of whether the SPA is approved as executed or approved with the condition that the SPA be modified in accordance with Staff's recommendations, YCA's request for relief should be denied. Southwest appreciates the Commission's consideration of the above facts and respectfully requests it approve the SPA, either as originally proposed by Southwest and YCA, or as modified by the provisions incorporated in Staff's April 20, 2007 report to the Commission.

Sincerely,

Karen Haller  
Assistant General Counsel and Director,  
Legal Affairs

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